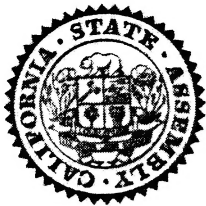


REPORT OF THE  
OFFICE OF THE AUDITOR GENERAL  
TO THE  
JOINT LEGISLATIVE AUDIT COMMITTEE

235.4

REPORT ON A REVIEW OF THE  
CALIFORNIA EGG PROGRAM --  
A MARKETING ORDER ESTABLISHED  
UNDER THE CALIFORNIA MARKETING ACT

APRIL 1976



# Joint Legislative Audit Committee

OFFICE OF THE AUDITOR GENERAL

## California Legislature



CHAIRMAN  
MIKE CULLEN  
LONG BEACH

MIKE CULLEN  
CHAIRMAN

VICE CHAIRMAN  
CLARE BERRYHILL  
CERES

ASSEMBLYMEN  
DANIEL BOATWRIGHT  
CONCORD  
EUGENE A. CHAPPIE  
ROSEVILLE  
BOB WILSON  
LA MESA

SENATORS  
ANTHONY BEILENSON  
BEVERLY HILLS  
GEORGE DEUKMEJIAN  
LONG BEACH  
JAMES R. MILLS  
SAN DIEGO

April 27, 1976

The Honorable Speaker of the Assembly  
The Honorable President pro Tempore of  
the Senate  
The Honorable Members of the Senate and the  
Assembly of the Legislature of California

Members of the Legislature:

This Auditor General report on a moribund program (California Egg Program) reflects inattentiveness of the Director of Food and Agriculture to the administration of the California Marketing Act of 1937.

Food producers, as well as Legislators, will be disturbed by the revelations on pages 19 through 27. Who is watching the store?

The auditors are Phillips Baker, Audit Manager; Gary S. Ross; Ross A. Luna; Nancy L. Szczepanik; and Dennis L. Sequeira.

Respectfully submitted,

MIKE CULLEN, Chairman  
Joint Legislative Audit Committee

TABLE OF CONTENTS

	<u>Page</u>
SUMMARY	1
INTRODUCTION	5
BACKGROUND	7
FINDINGS	
Management of the California Egg Program did not exercise adequate control over the operation of the surplus egg pool.	11
Recommendations	22
A subcommittee of the California Egg Advisory Board regularly held executive sessions in violation of the Government Code.	24
Recommendation	24
The high administrative costs of the California Egg Program as compared to other large programs indicate the need for a comprehensive study of marketing order programs' costs by the Department of Food and Agriculture.	25
Recommendation	27
A management employee of the California Egg Program had outside employment which may have been a serious conflict of interest.	28
Recommendation	30
WRITTEN RESPONSE TO THE AUDITOR GENERAL'S REPORT	
Department of Food and Agriculture	31

SUMMARY

The California Egg Program was initiated in California on July 12, 1972 by the Department of Food and Agriculture after a vote of eligible producers. The operations of the surplus egg pool administered under this program resulted in criticism from producers who were successful in having the program terminated on December 31, 1975.

The following are the findings and conclusions of this review relative to the operations of this program. It is hoped that the recommendations in this report can be useful to the Department of Food and Agriculture in administering those marketing orders which are to continue in operation.

<u>Finding</u>	<u>Page</u>
Management of the California Egg Program did not exercise adequate control over the operation of the surplus egg pool.	11

Conclusion

The operation of the surplus egg pool was not adequately controlled by management of the California Egg Program.	22
------------------------------------------------------------------------------------------------------------------	----

Recommendations

Page

We recommend that if surplus diversion pools are established in other marketing orders, the Department of Food and Agriculture implement the following procedures:

1. Require competitive bidding for all pool sales
2. Require proof of the ultimate disposition of all sales of surplus pool products
3. Require competitive bidding for the processing of surplus pool products by private organizations
4. Require storage of surplus products in state facilities or bonded warehouses under the control of the Department of Food and Agriculture to insure they will not be comingled with the breakers' inventory. An alternative would be to require the surplus product to be labeled as state property.

Finding

Page

A subcommittee of the California Egg Advisory Board regularly held executive sessions in violation of the Government Code.

24

Conclusion

The executive sessions of the Appeals Committee violated state "open meeting" laws.

24

Recommendation

The Department of Food and Agriculture should regularly review the activities of all marketing order boards to insure no further violations of the state "open meeting" laws occur.

24

Finding

The high administrative costs of the California Egg Program as compared to other large programs indicate the need for a comprehensive study of marketing order programs' costs by the Department of Food and Agriculture.

25

Conclusion

The variation in marketing order program expenses justifies the need for a complete review by the Department of Food and Agriculture.

26

<u>Recommendation</u>	<u>Page</u>
We recommend that the Department of Food and Agriculture review the operations of all marketing order boards and establish guidelines for administration and expenses of each of the boards.	27
<u>Finding</u>	
A management employee of the California Egg Program had outside employment which may have been a serious conflict of interest.	28
<u>Conclusion</u>	
A management employee of the California Egg Program had outside employment which may have been a conflict of interest in violation of Bureau Policy Letter No. IV-11.	30
<u>Recommendation</u>	
We recommend that the Department of Food and Agriculture initiate a complete review of the outside activities of all marketing order board employees to insure that no violations of conflict-of-interest rules exist.	30

## INTRODUCTION

In response to a legislative request, we have reviewed the California Egg Program administered by the Egg Advisory Board, under the general supervision of the Director of the Department of Food and Agriculture.

The California Egg Program was established by the California Marketing Act of 1937, which authorized the implementation of grading and inspection standards, advertising and promotion, research, and market stabilization. Market stabilization included the creation of a surplus egg pool, which is a form of supply management during periods of excess production.

The California Egg Program was terminated on December 31, 1975; however, the majority of the staff was still on the payroll as of March 31, 1976. The decision of the industry to terminate the egg program reflected the dissatisfaction of a majority of producers with the California Egg Program.

We contacted producers, breakers, dealers and export brokers to determine their attitudes and experiences with the Program, and to verify the accuracy of accounting data pertaining to program activities. We appreciate the interest and cooperation of all of those organizations. The cooperation of the staff of the Department of Food and Agriculture



and particularly the Bureau of Marketing has been outstanding on this assignment.

It is hoped that recommendations for corrective action in this report can be useful to the Department in administering those marketing orders which are to continue in operation.

BACKGROUND

In 1956, California produced 7.4 percent of the nation's egg supply. By 1960 this figure had grown to 9.1 percent and California producers found it necessary to market their excess production outside the State. In 1972 California produced about 12 percent of the nation's eggs.

In 1974 there were 416 egg producers in California, delivering over 50 cases each per week, with an estimated laying flock of 38.9 million birds. California egg production averaged 453,000 cases (30 dozen eggs per case) per week with approximately 10 percent being exported to egg deficient areas in neighboring states.

Problems facing the industry include oversupply brought about by a definite trend to larger operations and reduced per capita egg consumption caused in part by concerns for blood cholesterol levels and a change in breakfast eating habits.

The California Egg Program was initiated on July 12, 1972 after a referendum in which 73.8 percent of the eligible producers voted for the program. The program was financed by a 7-1/2 cent per case assessment on producers. Three cents per case was for advertising and sales promotion, and 4-1/2 cents was for administration. Only producers marketing in excess of an average of 50 cases per week were assessed, and only they were eligible to vote for or against the program.

The original marketing order was extended by producers in December 1973 for the two years concluded on December 31, 1975. Sixty percent of eligible producers voted to extend the marketing order.

One of the more significant and controversial activities of the California Egg Program was the diversion of "surplus" eggs. Initially each producer was allocated a production unit based on his historical production records. In periods of excess supply, producers were required to limit production to their allotment, or divert eggs to the surplus pool for sale in "non-normal" channels of distribution.

Subsequently, operation of the surplus pool brought criticism of the California Egg Program by a segment of producers who petitioned for termination of the program. Even though 60 percent of eligible producers signed a petition for termination, which was certified by the Department of Food and Agriculture on July 29, 1975, questions arose as to the legality of the petition. These questions were resolved by an Attorney General's opinion issued July 24, 1975 which held the program to be terminated on December 31, 1975.

An attempt to initiate a new marketing order for eggs was rejected by 58 percent of the eligible producers voting in a referendum concluded on November 12, 1975.

Recently a federal program for nationally coordinated egg research and consumer information was adopted through a nationwide

referendum of egg producers. The new program will cost producers up to five cents per case and will continue some of the advertising and sales promotion activities formerly financed by the California Egg Program.

The California Egg Program was the first marketing order to invite consumer participation in its program, and two consumer members were appointed to its Advisory Board in 1974. The egg program has sponsored significant research of the physiological effect of eggs in the diet and provided valuable assistance to consumers in the form of (1) egg recipes for home use and school lunch programs, (2) egg preparation demonstrations at fairs and other public gatherings, and (3) a wealth of published material on egg production.

During the course of the audit, the overwhelming complaint of producers dealt with the administration of the surplus egg pools, and the most significant findings in this report deal with the operation of the surplus egg pool.

During its three and one-half-year lifespan, the California Egg Program collected and disbursed in excess of \$4.0 million; of this amount, approximately 53 percent went to research and advertising and the balance for program administration. The following is a statement of the source and application of funds for the California Egg Program through September 30, 1975.

CALIFORNIA EGG PROGRAM SOURCE AND APPLICATION OF FUNDS  
FOR THE PERIOD JULY 12, 1972 THROUGH SEPTEMBER 30, 1975  
(Prepared from unaudited statements of the Department of Food and Agriculture)

	Total		Advertising Promotion And Research		Administration		Surplus Pools	
	Budgeted	Actual	Budgeted	Actual	Budgeted	Actual	Budgeted	Actual
Source of Funds:								
Assessments		\$3,925,183		\$2,554,860	\$1,418,600	\$1,370,323		\$382,773
Pool sales (gross)	\$4,322,700	382,773	\$2,904,100					
Penalties		3,298		2,214		1,084		
Interest & Miscellaneous		78,521		44,089		34,287		145
Net budgeted funds carried over - 1973 through 1975	226,346							
Total receipts	\$4,549,046	\$4,389,775	\$2,904,100	\$2,601,163	\$1,644,946	\$1,405,694		\$382,918
Use of funds:								
Salaries and wages	\$741,500	\$612,460			\$741,500	\$612,460		
Services and supplies	84,000	64,469			84,000	64,469		
Equipment	19,000	11,914			19,000	11,914		
Communication	73,000	69,186			73,000	69,186		
Rent	59,000	46,405			59,000	46,405		
Travel	224,250	159,694			224,250	159,694		
Automobile operation	23,000	21,414			23,000	21,414		
Insurance and bonds	65,000	79,591			65,000	79,591		
Accounting and statistics	14,750	14,439			14,750	14,439		
Advertising	2,350,100	1,928,649	\$2,350,100	\$1,928,649				
Promotion	204,500	189,304	204,500	189,304				
Research	109,000	38,576	109,000	38,576				
Public relations	29,000	29,252	29,000	29,252				
Publicity and education	211,500	193,183	211,500	193,183				
Surplus pool expenses	127,074	180,163			127,074			\$180,163
Other	13,750	10,017			13,750	10,017		
Total operating expenditures	4,348,424	3,648,716	2,904,100	2,378,964	1,444,324	1,089,589		180,163
Departmental charges:								
Administration	35,000	30,640			35,000	30,640		
Bureau of Marketing	149,000	124,619			149,000	124,619		
Prorata - Attorney General	4,750	1,561			4,750	1,561		
Preliminary expenses	11,872	12,504			11,872	12,504		
Total	200,622	169,324			200,622	169,324		
Cash payments to producers		202,327						202,327
Cash available for expenditures		369,408		222,199		146,781		428
Total expenditures and cash available	\$4,549,046	\$4,389,775	\$2,904,100	\$2,601,163	\$1,644,946	\$1,405,694		\$382,918

FINDINGS

MANAGEMENT OF THE CALIFORNIA EGG PROGRAM  
DID NOT EXERCISE ADEQUATE CONTROL OVER  
THE OPERATION OF THE SURPLUS EGG POOL.

The California Egg Program provided for the creation of surplus egg pools during periods of oversupply. The "surplus" eggs were liquified and frozen in 30-pound containers by contract egg-breaking firms for eventual sale into "non-normal" channels of distribution. The purpose of the surplus pool was to stabilize egg prices by balancing egg supplies with demand.

In our opinion, the surplus egg pool was inadequately administered and resulted in the following significant deficiencies.

The Surplus Egg Pool Had Minimal Effect  
Upon Reducing the Supply of Eggs.

The surplus egg diversion activity of the California Egg Program has been criticized by consumer groups that believed such activity resulted in an unjustified increase in the price of eggs. This criticism might have been warranted if the diversion activity had been effectively implemented and operated; however, other factors beyond the control of the California Egg Program negated or compromised the purpose of the surplus egg pool and rendered it largely ineffective in managing the supply of eggs.

Three factors which were under the control of the California Egg Program served to lessen the effectiveness of the surplus egg pools. These factors were:

1. Eggs frequently were not diverted by producers during the designated pool period. Instead they were delivered late or in some instances not at all. The management's efforts to force compliance in this area were largely unsuccessful and the final pool period ended February 1, 1975. As of December 15, 1975, 5,343 cases of eggs were still outstanding from producers. Further, if the diversion of eggs had been successful, those producers who complied with the diversion requirements would have enriched their competitors who did not comply and who were therefore in a position to take advantage of higher market prices resulting from the diversion.
2. The California Egg Program allocated production limits of 524,000 cases of eggs per week, while the weekly egg production record set in 1971 is only 481,000 cases. Allocating production "limits" greater than actual production levels assured most producers of unrestricted production.
3. Surplus pool frozen egg products were frequently sold into "normal" market channels, thereby seriously compromising the intent of the pool. This factor is discussed more fully in the following pages of this report.

The following additional factors which were beyond the control of the Program minimized the need for or the intended effect of the surplus pool.

1. During the first pool period (November 12, 1972 through July 29, 1973), approximately 10 percent of the laying flock in California was slaughtered in an attempt to control an epidemic of Newcastle disease. Another 15 percent of the flock had been slaughtered just before the first pool period. The laying flock was therefore reduced by approximately 25 percent.
2. Eggs imported from out of state were exempt from the surplus pool. During pool period one, out-of-state imports increased by 7,000 cases per month; whereas the total volume of California eggs diverted during the entire 37-week pool period was just over 7,500 cases. Therefore, the increase in out-of-state imports in a single month replaced all the eggs diverted in pool period one.

Management of the California Egg Program stated that because of the supply management program (surplus egg pool) many producers did not expand their flocks and therefore the problem of overproduction was not aggravated. This hypothesis cannot be confirmed or denied and, therefore, we take no position as to the validity of the argument.



Eggs Diverted under the Surplus Pooling  
Activities of the California Egg Program  
Were Sold into Normal Domestic Marketing  
Channels in Violation of the Marketing  
Order Provisions.

The California Egg Marketing Order stated that any eggs diverted to the surplus pool were to be sold through "non-normal" channels. A "normal" channel was defined as "the usual market for eggs for human consumption in fresh or processed form, whether within or outside the state". This definition is ambiguous since California eggs, both fresh and processed, are sold in market areas throughout the United States and in export markets. It is therefore unclear where surplus pool eggs could be sold on a non-normal marketing basis.

As an example of a non-normal marketing channel, diverted eggs could be provided to charitable organizations on a "gratuitous basis". However, these charitable organizations were sold less than one percent of the total poundage of surplus eggs marketed by the California Egg Program.

The Egg Advisory Board was to provide proper safeguards to ensure that no eggs of any surplus pool would compete directly in normal marketing channels. Once a sale was made, however, the Board made no arrangements for the buyer to provide any documentation that the eggs were actually sold in non-normal channels. The only assurance that the eggs would not be sold in normal marketing channels was the buyer's oral or written statement that he agreed to not sell the frozen product in the domestic market.

We found that only seven percent of the diverted eggs sold had documentation supporting sales in "non-normal" markets. As a result of the Board's failure to require documentation on all sales, "diverted" eggs were frequently sold in normal domestic-marketing channels. At least 45 percent of the eggs diverted to the surplus pool reached clearly normal domestic market channels in direct violation of the terms of the marketing orders for eggs. These eggs were purchased from the program at prices considerably below the domestic market price. In at least one instance the eggs were immediately resold at a profit without the pool buyer taking physical possession.

The buyer of 88 percent of the surplus pool eggs manufactures an egg-substitute product. The egg substitute required only egg whites; the yolks were a by-product of the manufacturing process. The president of this firm stated that under a verbal agreement with the California Egg Program, his company was allowed to purchase surplus eggs to sell in the normal domestic market if a comparable amount of the yolk by-product was sold in the export market. Such an agreement violates the terms of the marketing order for eggs. An analysis of this company's foreign sales showed large exports of frozen egg yolks.

The California Egg Program Marketed Surplus Pool Eggs Without Competitive Bid at Prices Substantially Below Prevailing Markets. As A Result, Producers Received as Little as 15 Cents Per Dozen for Diverted Eggs.

Summarized below are the proceeds from the sales of pool eggs and the return to producers from Pool No. 1, No. 2 and No. 3.

<u>Surplus Eggs Sold</u>	<u>Pool 1</u>	<u>Pools 2 &amp; 3*</u>
Cases	<u>7,838</u>	<u>31,918</u>
Dozens of Whole Eggs	<u>235,143</u>	<u>957,540</u>
Pounds of Frozen Eggs	<u>273,736</u>	<u>1,125,780</u>
Gross Sales Price	\$89,084	\$293,689
Less: Processing & Handling	31,133	149,030
Over(under) Payment to Producers	<u>4,744</u>	<u>(5,027)</u>
Net Return to Producers	<u>\$62,695</u>	<u>\$139,632</u>
Net Return per Dozen/Whole Eggs to Egg Producers	27¢	15¢

\*As of September 30, 1975.

The decrease in the return to producers from 27 cents to 15 cents was primarily due to 90 percent of the eggs under Pools No. 2 and 3 having been sold for substantially lower prices than those sold under Pool No. 1.

The frozen egg market prices when surplus eggs were sold by the California Egg Program are presented below with comparative market quotations.

Comparison Between California Egg Program  
Selling Prices and Other Established Market Prices

Buyer	Date of Sale	Poundage Sold	CEP Selling Price	**Urner Berry Quotation	Chicago Market Quotation
			Price/Pound		
Nulaid	12/72	58,229	\$0.28	\$0.275	\$0.2742
Nulaid	2/73	34,160	.30	.3125	.3125
Nulaid	3/73	62,890	.32	.3325	.335
Nulaid	7/73	57,544	.37	.495	.4769
Nulaid	8/73	26,880	.39	.5975	.6032
*Olson Farms, Inc.	12/73	34,033	.31	--	--
Nulaid	4/74- 8/74	225,000	.30	.353	.345
Henningsen	1/75	105,000	.32	.353	.3585
Senior Citizens	1/75- 7/75	3,720	.35	.352	.348
Nulaid	3/75- 5/75	789,660	.24	.338	.3343
Senior Citizens	5/75- 8/75	2,400	.30	.382	.379
Nulaid	11/75	110,340	.24	.4122	.418
Nulaid	10/75- 12/75	105,390	.35	.415	.411
Senior Citizens	12/75	480	.35	.425	No Quote

\*Included both shell eggs and frozen product.

\*\*Urner Berry is considered to be the pricing standard in the egg industry. San Francisco commodity prices were not used because they reflect less-than-carload prices and are therefore not comparable.

A comparison of the prevailing average market prices with the unit prices of the frozen whole eggs sold by the California Egg Program shows that the prevailing market prices were sharply higher than the prices received by the California Egg Program.

Article VI of the Marketing Order for Eggs permitted the distribution of surplus eggs to charitable organizations on a gratuitous basis. However, Program management issued a letter to various charities on December 24, 1974 which stated in part:

...First, the eggs are not being provided on a gratuitous basis to any of the organizations. The eggs are being offered for sale at the same price which they would bring if they were used to develop overseas markets.

Sales of surplus eggs to charitable organizations were at prices consistently higher than those charged commercial buyers; however, it must be emphasized that the quantities purchased were much smaller.

California Egg Program management stated that surplus pool eggs were sold at prices lower than those prevailing in established markets because these eggs were not to be sold in normal domestic channels. However, we found that surplus pool eggs did enter normal domestic channels of distribution in violation of the terms of the marketing order.

The California Egg Program Did Not  
Implement Adequate Control Procedures  
and Did Not Make Audits of Surplus  
Pool Egg-Breaking Activities.

Egg producers who exceeded their allocated production base were required to divert eggs to a surplus egg pool. The pool would in turn send the eggs to an egg-breaking firm who would process the eggs into frozen product for eventual sale into "non-normal" distribution channels.

The California Egg Program paid over \$180,000 to nine breaking plants without competitive bids, written contracts, or bonding arrangements to protect the State in the event of default. The Marketing Order for Eggs specifically requires written contracts with egg-breaking firms.

The California Egg Program also had no written procedures on how surplus pool eggs were to be processed by the breaking plant. As a result, each authorized breaking plant processed the diverted eggs differently. Some breaking operations weighed the eggs to insure they met the 44-pound minimum weight required in the marketing order, while others did not. Some "breakers" processed their own eggs with California Egg Program eggs while others processed California Egg Program eggs separately. After the eggs were broken, some breakers kept a separate physical inventory for California Egg Program product, while others mixed their inventory with California Egg Program eggs.

The lack of consistent procedures for the control of surplus pool eggs during the breaking operations resulted in significant variations in the yield of frozen egg product received from different "breakers".

The yield of liquid egg product extracted varied from 34 pounds to 37.99 pounds per case of eggs; the average for the entire Program as of September 12, 1975 was 35.4 pounds per case. By comparison, the average yield in all breaking plants in the nation for fiscal year 1974 was 37.87 pounds per case.

The largest breaker of eggs for the Program consistently reported receiving cases of eggs exactly meeting the 44-pound per case minimum requirement. Of the 15,823 cases delivered to this breaker by various producers as of September 12, 1975, 14,505 (91 percent) exactly met the 44-pound minimum. By contrast, other authorized breaking operations reported that cases received varied in weight. The manager at the breaking plant which consistently reported receiving eggs at 44 pounds per case stated that he believed a verbal agreement existed between his organization and the California Egg Program whereby all eggs received were to be considered as 44 pounds net per case. This was denied by California Egg Program management.

The California Egg Program made no audits of breaking plant operations to determine the reason for consistently low yields at some breaking plants. The Program diverted over 39,000 cases of eggs and the total yield of frozen egg product can be conservatively valued at 30

cents per pound. If the California Egg Program yield had reached the national average of 37.84 pounds per case, producers would have received an additional \$28,899.

Our audit included a physical count of frozen egg-product inventory reported as belonging to the California Egg Program as of October 22 and 23, 1975. The inventory consisted of 7,868 30-pound cans of frozen whole eggs. Of this total, 6,020 cans (77 percent) were not identifiable as California Egg Program property either on the cans or in warehouse documentation.

As indicated by the label or sticker dates on the 6,020 cans, the eggs were broken and packed by the breakers during March, May and June of 1975. These eggs were to have been diverted during the second surplus pool period which ended August 31, 1974. The Egg Board manager said that there was an oral agreement with the authorized breaking plants whereby they could rotate California Egg Program eggs with their own stock. This procedure would enable a breaking plant to trade in California Egg Program inventory to their best advantage. If the market was up they could sell the California Egg Program product, and repay the Program when the market for shell eggs dropped sufficiently to make replenishment attractive.

Basic internal control procedures were not used by California Egg Program in the sale of surplus eggs. For instance, prenumbered invoice receipts intended for use in recording or acknowledging cash



remittances from the sales of frozen eggs were missing from the invoice files of the California Egg Program. We were told the invoice receipts in question were issued for outside business purposes not connected with the California Egg Program.

Most of the above conditions pertaining to the operation of the surplus pool were not a violation of regulations because no such regulations existed. However, such practices are inconsistent with accepted business principles and sound judgment. The California Egg Program was acting as trustee for the egg producers who consigned eggs to the pool; Program management should have instituted controls to insure that the producers' property was protected. We were unable to verify the accuracy and reliability of the surplus pool transactions recorded in the accounts of the California Egg Program from July 1972 through September 1975.

#### CONCLUSION

The operation of the surplus egg pool was not adequately controlled by management of the California Egg Program.

#### RECOMMENDATIONS

We recommend that if surplus diversion pools are established in other marketing orders, the Department of Food and Agriculture implement the following procedures:

1. Require competitive bidding for all pool sales
2. Require proof of the ultimate disposition of all sales of surplus pool products
3. Require competitive bidding for the processing of surplus pool products by private organizations
4. Require storage of surplus products in state facilities or bonded warehouses under the control of the Department of Food and Agriculture to insure they will not be comingled with the breakers' inventory. An alternative would be to require the surplus product to be labeled as state property.

A SUBCOMMITTEE OF THE CALIFORNIA EGG  
ADVISORY BOARD REGULARLY HELD EXECUTIVE  
SESSIONS IN VIOLATION OF THE GOVERNMENT  
CODE.

The Appeals Committee regularly held executive (closed door) sessions when considering appeals from egg producers concerning production-base allocations under the surplus pool program. California Egg Program procedures issued March 26, 1974 stipulate that "appeals...will be heard in executive sessions...."

The Legislative Counsel issued an opinion on November 17, 1975 which stated that the California Egg Program is subject to the "open meeting" law and further that executive session of the Board and its subcommittees could only be held when considering personnel matters, or when conferring with an attorney regarding litigation.

CONCLUSION

The executive sessions of the Appeals Committee violated state "open meeting" laws.

RECOMMENDATION

The Department of Food and Agriculture should regularly review the activities of all marketing order boards to insure no further violations of the state "open meeting" laws occur.

THE HIGH ADMINISTRATIVE COSTS OF THE CALIFORNIA EGG PROGRAM AS COMPARED TO OTHER LARGE PROGRAMS INDICATE THE NEED FOR A COMPREHENSIVE STUDY OF MARKETING ORDER PROGRAMS' COSTS BY THE DEPARTMENT OF FOOD AND AGRICULTURE.

The following summary shows comparative ratios of administrative costs incurred by the eight largest marketing boards of the Department of Food and Agriculture for the fiscal years 1972-73, 1973-74 and 1974-75. These marketing order boards were selected for comparative purposes from 34 existing marketing boards and councils. Each of the eight marketing boards had annual expenditures of at least \$1 million.

<u>Marketing Order</u>	<u>Administrative Cost</u> <u>As a % of Total Expenditures</u>		
	<u>1974-75</u>	<u>1973-74</u>	<u>1972-73</u>
Milk Advisory Board	2.3	3.4	3.4
Wine Advisory Board	7.6	5.6	4.2
Clingstone Peach Advisory Board	3.1	7.1	5.7
Prune Advisory Board	7.0	6.2	9.7
Dairy Council	11.7	12.3	12.0
Avocado Advisory Board	4.0	9.0	9.5
Raisin Advisory Board	2.4	4.3	16.9
Egg Advisory Board	30.3	34.7	44.6

The California Egg Program had the highest ratio of administrative cost to total expenditures when compared to the other large state marketing order boards. A contributing factor to this high percentage of administrative cost was the surplus pool activity which required five full-time

positions to provide field enforcement activities. However, the surplus pool activities concluded on February 1, 1975, yet these five full-time positions were still on the payroll as of March 31, 1976.

The manager of the California Egg Program was formerly a deputy director of the Department of Food and Agriculture. His salary at the Board was \$39,000 per year. Nineteen of the marketing order boards hire managers to supervise their programs at salaries up to \$43,096 per year. No departmental policy exists with regard to the determination of a "fair salary" payable to these managers.

We did not analyze in detail the program and administrative expenditures of the other marketing boards. The fact that the administrative cost ratios of the California Egg Program were from three to thirteen times more than those of the other large state marketing boards justifies the need for a complete review by the Department of Food and Agriculture of the program cost of administration of the various marketing boards.

#### CONCLUSION

The variation in marketing order program expenses justifies the need for a complete review by the Department of Food and Agriculture.

RECOMMENDATION

We recommend that the Department of Food and Agriculture review the operations of all marketing order boards and establish guidelines for the administration and expenses of each of the boards.

A MANAGEMENT EMPLOYEE OF THE CALIFORNIA  
EGG PROGRAM HAD OUTSIDE EMPLOYMENT WHICH  
MAY HAVE BEEN A SERIOUS CONFLICT OF  
INTEREST.

The assistant manager of the California Egg Program had an interest in the California egg industry other than that as an employee of the California Egg Program. The duties of the position of assistant manager required the use of confidential flock production records of individual producers within this State. This position paid a salary of \$26,000 per year.

This assistant manager was concurrently employed as secretary-manager of a Northern California egg cooperative. The cooperative's purpose was to collect assessments from member-producers based on egg production, and turn over the proceeds to a national trade association. The secretary-manager maintained the financial records, billed members for assessments, and kept the minutes of cooperative meetings. The position required his services one day per month for which he was paid \$200 monthly.

Department of Food and Agriculture, Bureau of Marketing Policy Letter No. IV-11 defines "...activities...in conflict with their duties" as board employees to include:

- 11A. Providing or divulging confidential information, data, or records to any person to whom the issuance of such information, data, or records has not been authorized, using such confidential information, data, or records

for personal gain or advantage, or providing or using confidential records for unauthorized mailing lists.

Any use of the confidential production records of the California Egg Program to determine any assessments owed by member-producers to the cooperative would be a conflict of interest.

Industry trade letters show the street address of the egg cooperative to be the same as that of the California Egg Program -- 555 Capitol Mall, Suite 425. The egg cooperative's stationery, with a post office box number for the return address, was stored in the supply room of the California Egg Program. No rent was paid to the Board by the cooperative.

Logs of individual items of expense, such as long distance telephone calls, postage, and copying, were not maintained by the California Egg Program. Since the office facility and the California Egg Program assistant manager were serving dual functions, it is possible that this Northern California egg cooperative also used support personnel, equipment, supplies, and other expense items paid by the California Egg Program.



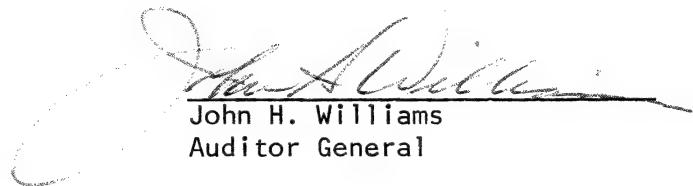
CONCLUSION

A management employee of the California Egg Program had outside employment which may have been a serious conflict of interest in violation of Bureau Policy Letter No. IV-11.

RECOMMENDATION

We recommend that the Department of Food and Agriculture initiate a complete review of the outside activities of all marketing order board employees to insure that no violations of conflict-of-interest rules exist.

Respectfully submitted,



John H. Williams  
Auditor General

April 20, 1976

Staff:

Phillips Baker  
Gary S. Ross  
Ross A. Luna  
Nancy L. Szczepanik  
Dennis L. Sequeira

THE DEPARTMENT OF FOOD AND AGRICULTURE'S  
RESPONSE TO AUDITOR GENERAL'S REPORT  
ON THE  
CALIFORNIA EGG PROGRAM

The California Egg Program (CEP) terminated on December 31, 1975. Surplus pool activities of that program were not operated after February 1, 1975.

The surplus pool on which the Auditor General's report focused was but one phase of a multipurpose program which included advertising, promotion, research and statistics as well as the surplus egg pool.

During the CEP's operation, the abundance of supply relative to the demand for eggs was dealt with in four ways: (1) through intermittent use of a surplus diversion pool which attempted to balance short-run supplies with demand; (2) through the use of advertising and promotion; (3) through research, to determine the nutritive values and health aspects of eggs so consumers could make more informed egg purchase decisions; and (4) through statistical reports and projections designed to improve market information and assist producers in production responses.

The Department of Food and Agriculture's complete terminal audit of the surplus pool transactions of the California Egg Program is consistent with a policy of closely auditing all marketing order programs.

The activities of all marketing order boards are supervised by the Department to ensure that State "open meeting laws" are complied with on matters which are not otherwise restricted by laws requiring protection of the privacy of the individual or the details of his business.

The administration and budgets of each marketing order advisory board, including administrative expenditures, are continually reviewed by the Department. The Department is currently drafting conflict of interest and financial disclosure regulations for all marketing order board members and employees to be in compliance with the rules and regulations recently adopted by the Fair Political Practices Commission.

Errors of fact, logic and conclusions were identified by the Department of Food and Agriculture in the Draft Report of the Auditor General on the California Egg Program dated April 1976. Many of these errors are outlined below.

Specific Comments on Draft of Auditor General's Report:

Page 3.

The executive sessions of the Appeals Committee of the Egg Advisory Board dealt with the confidential business affairs of individual egg producers. Such private information is in the area of personnel matters which may be considered in executive sessions under the "open meeting" law.

The budgeted administrative costs of each advisory board are evaluated at least annually. The Department is presently engaged in a general study of management, salaries, staff benefits and expenses which will apply to all advisory boards.

Page 5.

\* Some members of the staff of the Egg Advisory Board were on the payroll until April when accrued vacation time was expended.

The dissatisfaction of producers as a factor in termination was not supported by factual analysis. The fact that many producers who signed the petition to terminate the marketing order have since signed the new voluntary egg agreement for advertising, promotion and research was not mentioned.

Page 7.

The statement on assessment rates should indicate that the amounts stated were included in the original marketing order through 1973. For a major portion of the total term of the California Egg Program, the assessment rates were 5 cents per case for advertising and 2 cents per case for administration.

Page 8.

The question regarding legality of persons withdrawing names from a petition occurred before the Department's decision of July 29, 1975, which fully respected the Attorney General's Opinion issued 5 days before on July 24.

Pages 11, 12 & 13.

Analysis is lacking to support the conclusion that, because the surplus egg pool was "inadequately administered," it had minimal effect upon reducing the supply of eggs. In fact, during the pool period, there was a reduction in production of approximately 20,000 cases per week due to flock reduction to comply with the CEP.

The report indicates the egg program efforts to enforce compliance of delivery of eggs to the surplus pool failed and states that 5,343 cases of eggs were still owed to the pool as of December 15, 1975. This

deficit was recognized by CEP management as caused principally by two producers who failed to deliver eggs to the pool and who are now engaged in court action initiated by the Attorney General. Most producers subject to the surplus pool regulations complied through flock reduction.

The Auditor General's report presents no evidence on the economics of trade, including the relative prices of eggs in different areas, and the costs of transportation as a possible explanation for the increased movement of eggs. The audit team did not analyze on-farm egg prices during the period for which program ineffectiveness is evaluated.

Page 14.

The statement that surplus eggs were sold in normal marketing channels in violation of the marketing order is based upon a difference between the Auditor General's definition and the CEP's definition of a normal market when approving the export sale of surplus eggs.

Page 17.

The Urner Berry price quote used by the Auditor General is presumably the delivered price of egg product in the Eastern U.S. market. CEP sold egg products in the world market; a comparable price was not included in the Auditor General's report. The world price for eggs bears no consistent relationship to domestic prices. Except for sales to charities, the prices received by CEP were F.O.B. warehouse.

Page 18.

Sales of eggs to charitable organizations were on a small-lot (480 to 3,720 pounds) basis delivered at destination. Sales to commercial buyers were on a large-lot (26,880 to 789,660 pounds) basis, F.O.B. the storage plant.

Page 19.

The Administrative Rules and Regulations issued for the CEP contain the details on surplus pool operations. Part 3C(4) of the Administrative Rules and Regulations, made effective September 3, 1972, required execution of a contract between the Board and the dealer handling eggs. In line with this requirement, breaking plants had on file with the CEP a written statement as to the cost which would be reimbursed for the services rendered.

Page 21.

No evidence was presented that any of the breaking plants involved in processing surplus pool eggs acted in the manner alleged in paragraph 3.

Page 26.

The high administrative costs of the CEP, when compared to those marketing orders cited, reflect the higher costs of operating a program involving supply management.

cc: Members of the Legislature  
Office of the Governor  
Office of the Lieutenant Governor  
Secretary of State  
State Controller  
State Treasurer  
Legislative Analyst  
Director of Finance  
Assembly Office of Research  
Senate Office of Research  
Assembly Majority/Minority Consultants  
Senate Majority/Minority Consultants  
California State Department Heads  
Capitol Press Corps